IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1945

No.....

CORNELIUS J. COLLINS, ET AL.,
Petitioners,

vs.

LESTER L. SEIFRIED,
Respondent.

SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

BRIEF IN SUPPORT OF PETITION.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is not yet officially reported but is printed in full in the Record (R. 116-119).

STATEMENT OF THE CASE.

A statement of the matter involved has been fully presented in our petition and the Court is respectfully referred to pages 4 to 9 herein. In the interest of brevity the statement is not repeated here.

Specifications of Errors To Be Urged.

The Circuit Court of Appeals erred:

1. In holding that the creditors' petition for reorganization under Chapter X of the Bankruptcy Act was not filed in good faith.

2. In directing the District Court to dismiss the petition.

SUMMARY OF ARGUMENT.

A. The creditors' petition was not lacking in good faith within the meaning of Section 146 (4) where it appears a prior foreclosure proceeding under Illinois law is inadequate by comparison with Chapter X for the reorganization of the debtor, and where a conflict of interest exists between creditors and the sole right to foreclose is vested in the indenture trustee, creditors not being a party to said foreclosure and receiving no notice of said foreclosure.

B. Where the dominant creditor is a fiduciary by reason of being attorney for the indenture trustee in the state court foreclosure, his conduct must be on a higher level than that of persons dealing at arms length with each other and a bankruptcy court will not permit him to deal with the subject matter of his trust for his own benefit.

C. In the *Marine Harbor* case as distinguished from the present case, no conflict existed between creditors and the debtor did not sustain the burden of establishing good faith which federal statutes place on a petitioner. So far as the "interests" of stockholders were concerned they would not be denied in the State Court any benefits,

advantages or protection which Chapter X afforded, as it was conceded the debtor was insolvent. In the instant case a conflict exists among the only class of creditors, and the state court procedure was inadequate as compared with Chapter X to protect all creditors, and the prior foreclosure proceedings is controlled by a person who with selfish interest could be guilty of abuse.

ARGUMENT.

The Circuit Court of Appeals improperly found that the interests of the creditors and stockholders would be best subserved in the state court prior proceeding as in the instant case the local machinery for reorganization of the debtor is inadequate by comparison with Chapter X.

A.

A foreclosure proceeding under Illinois laws is inadequate by comparison with Chapter X for the reorganization of the Debtor. Under a foreclosure proceeding in the Illinois State Courts the only remedy that the court *must* grant is a sale to the highest and best bidder. Courts of equity having jurisdiction of foreclosure proceedings have general equity powers and have power to protect the interest of creditors and stockholders through reorganization *if the proper parties so desire.*

One of the cases cited in the opinion of the Circuit Court of Appeals in the instant appeal is the case of *First National Bank* v. *Bryn Mawr Beach Bldg. Corp.*, 365 Ill. 409, 9 N. E. 2d 654 (1937). In that case a bid at the master's sale was made by a representative of a *bondholders' com-*

mittee pursuant to an existing plan of reorganization which had been submitted the court for approval. The effect of the decision in that case was simply that a state court of equity may consider an existing plan of reorganization proposed by a bondholders' committee in deciding whether or not to grant its approval of a foreclosure sale. There is nothing in said decision which indicates that a minority bondholder may prevent a foreclosure sale by the alternative of an application to the court for a reorganization of the debtor. In the instant case there is no bondholders' committee and the Illinois Court lacks the power to compel Bishop to agree to a plan of reorganization in said foreclosure. Bishop owning two-thirds of the bonds can use his bonds in the bid at the foreclosure sale. Thus it can be seen that in a foreclosure proceeding a dominant bondholder is in a position to control said sale. As was said by the court in the case of *First National Bank* v. *Bryn Mawr Beach Bldg. Corp.*, 365 Ill. 409, 9 N. E. 2d 654 on page 426 in speaking of the advantages which a majority has over a minority in a foreclosure sale:

> "While ample notice of the sale was given yet it is but trite to say that anyone could bid who wished, for, as a court of equity cannot fail to recognize the advantageous position of the majority of the bondholders united, over the ununited minority who have not agreed to the reorganization plan, is such that, in the case of a very large property, unconscionable advantage may be taken of the latter."

As is evident from the record the instant foreclosure was not intended as a method of reorganization of the debtor (R. 31, 37), but is an attempt by Bishop to obtain a bargain purchase of the property at as cheap a price as possible.

The District Judge took judicial knowledge of the foreclosure laws of the State of Illinois in arriving at his finding of good faith and that under Section 146(4) he

could retain jurisdiction in the federal court if he found that the interest of creditors would be better subserved than in the prior proceeding. Even if there were a bona fide attempt to resort to the state court for the purpose of reorganization it would appear that in "substantial particulars" the state court could withhold or deny creditors the benefits, advantages or protection which Chapter X affords.

The inadequacies of the state court procedure as compared with the procedure under Chapter X are as follows:

1. In the instant case the exclusive right to foreclose the trust deed is vested in the indenture trustee, the bondholders are not necessary parties to the foreclosure proceeding, and are not parties either as plaintiff or defendant.

2. No notice of the filing of said foreclosure or of any of the steps in the proceeding were given nor had to be given to bondholders.

3. Bondholders do not have an absolute right of intervention in said foreclosure proceeding. As was said in the case of *American Trust & Safe Deposit Co.* v. *180 East Delaware Building Corp.*, 262 Ill. App. 67 (1931):

> "In view of the provisions of the trust deed as above set forth, it was not necessary to make any of the bondholders parties complainant or defendant to the bill. No bondholder has an absolute right of intervention, especially in the absence of any allegations of fraud, misfeasance or bad faith on the part of the trustee."

4. The fixing of an up-set price does not afford adequate protection to bondholders not a party to a plan of reorganization since it is discretionary whether the Illinois court will fix an up-set price and if it is fixed the standard is only that price which is not so grossly inadequate as to

shock the conscience of a court of equity. *Levy* v. *Broadway Carmen Bldg. Corp.*, 366 Ill. 279, 8 N. E. 2d 671 (1937).

5. The indenture trustee is in full control of the foreclosure proceedings and it is not subject to the wishes and desires of the bondholders.

6. The attorney for the indenture trustee need not be disinterested.

7. The court cannot compel the acceptance of a plan of reorganization nor to bind dissenters to a plan of reorganization.

8. No notice of the successive steps in the proceedings need be given to all the bondholders who are the only persons with a financial stake dependent upon the outcome of the foreclosure.

On the other hand Chapter X is far better equipped to supervise the reorganization procedure in the interests of all of the parties. The reorganization trustee and his attorney shall be disinterested (Section 156-8). Creditors receive notice of the hearing of the retention of the trustee. (Section 161), the filing of a plan by a trustee or any interested party, the date of hearing on the plan or any objections or amendments thereto (Sections 169, 170), the hearing for the consideration of said plan, and creditors alone vote on the acceptance of said plan if the debtor is insolvent (Section 179) as (Section 198) expressly limits the majority necessary for the acceptance of a plan to claims filed by the holders thereof and not by the indenture trustee. Before approving any plan the district court may seek the aid of the Securities and Exchange Commission for an advisory report. In addition the acceptance or failure to accept a plan under Chapter X must be made in "good faith" in order to be considered in determining the requisite majority for acceptance of the plan. Section 203. In the case of *Young* v. *Higbee Co.*, 324 U. S. 204 (1944) in a construction of said Section 203 on page 210:

> "If Potts and Boag had declined to accept this plan in bad faith the Court under Section 203 could have denied them the right to vote on the plan at all. The history of this provision makes clear that it was intended to apply to those stockholders whose selfish purpose was to obstruct a fair and feasible reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupts assets."

By controlling each step of the proceeding every possible and conceivable safeguard has been provided by Congress for the protection of all parties to a Chapter X proceeding. An Illinois Equity Court does not afford minorities any such protection. A comparison of the procedure in the Illinois State Court and of Chapter X and the safeguard provided therein indicate glaring deficiencies in the State Court procedure.

B.

One of the considerations which moved the district court to retain jurisdiction was the dual position of Bishop as dominant creditor and who by reason of his employment by the indenture trustee as attorney in the foreclosure proceeding became a fiduciary and as such in control of the proceedings where with selfish motives he could be guilty of abuse. Seifried as the objecting creditor is a nominee of Bishop. It is admitted that Bishop advanced all of the funds for the purchase of the securities (R. 24, 32, 37). Bishop owns 66% of the bond issue.

It appears that the foreclosure proceedings were filed in the Illinois state court on December 2, 1944 (R. 29). The creditors' petition for reorganization was filed on December 9, 1944 (R. 2). The Section 210 affidavit filed by Seifried discloses that after the filing of the complaint in foreclosure Bishop bought bonds from his *cestuis*. He was then a fiduciary.

In discussing the duties and obligation of a trustee it was said in the case of *White* v. *McQueen*, 360 Ill. 236 on page 247:

> "* * * A trustee will not be allowed to place himself in such a position that he may not perform his duty to the mortgagor and owner of the equity of redemption, as well as to the bondholders to see that the property brings the greatest amount possible * * * It may exact from him the utmost fidelity and good faith and will not permit him to deal with the subject matter of the trust for his own benefit."

Thus it can be seen that the conduct of Bishop, who is a fiduciary is on a much higher level than that of persons dealing at arm's length with each other. *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545 (1928). The facts in the instant case indicate that this is not a proceeding solely concerning the diverse interests of a majority bondholder and the minority bondholders. The majority bondholder by his own acts and conduct has caused himself to be saddled with the duties and obligations of a fiduciary. Why does Bishop, said fiduciary as well as objecting creditor resist so vigorously the jurisdiction of the federal court? A bankruptcy court being a court of equity may exact from him the utmost good faith and fidelity and will not permit him to deal with the subject matter of the trust for his own benefit. He can be called upon to account in the bankruptcy court in the reorganization proceedings for his purchases of securities from his *cestuis* and in the light of the circumstances the court may either disallow a portion of his claim so that he may not profit from said purchases or may subordinate a portion of said claim. *Pepper* v. *Litton*, 308 U. S. 295 (1939).

C.

We now come to a distinction of the instant case with that of *Marine Harbor Properties, Inc.* v. *Manufacturers*

Trust Co., 317 U. S. 78 (1942). The debtor's sole asset was an apartment building and it appeared the building was worth less than the senior indebtedness. The holders of the beneficial certificates were represented by a Schackno trustee. There was no equity in the assets for the junior creditors, and following unsuccessful attempts to reorganize under the state law, the bill of foreclosure was filed for the equal benefit of all members of the only class of creditors entitled to share in the proceeds. Shortly thereafter the debtor filed a voluntary petition under Chapter X and obtained an ex-party order approving the petition. The Schackno trustee then moved to vacate that order, dismiss the debtor's petition on the ground it was not filed in good faith. The opinion of the Supreme Court, after referring to the burden upon petitioner to "demonstrate that at least in some substantial particular the prior proceedings withhold and deny creditors or stockholders benefits, advantages or protection which Chapter X affords," first disposes of the interest of the equity owners who had instituted and supported the Chapter X proceeding. It was held that the debtor did not sustain the burden which federal statutes place on a petitioner, to show that so far as the "interests" of stockholders were concerned they would be denied in the State Court any benefits or advantages which Chapter X affords, as in either court the interest of stockholders would be extinguished, the debtor being insolvent.

The only portion of the opinion, therefore, which has any application to this case is that which deals with the interest of the first mortgage certificate holders. The court said on page 87:

> "There remains the contention that it was in the 'interests' of the certificate holders to have the proceedings transferred to Chapter X. In this connection much emphasis is placed on numerous safeguards contained in Chapter X * * * And it is asserted that

> comparative safeguards are wholly lacking in proceedings under the Schackno Act. These considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding dealing with more than one class of securities under the older procedures which Chapter X was designed to improve and supplant * * * Then the safeguards offered by Chapter X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises and settlements—steps which are basic to the reorganization process but which in selfish hands led to much abuse."

In the *Marine Harbor* case as distinguished from the present case no conflict exists within the only class of creditors affected and the local foreclosure was not the result of a race between the diligent. In the instant case there is a conflict of interest between the creditors and the numerous safeguards contained in Chapter X become as highly significant and important as if there were more than one class of creditors. Bishop is a dominant creditor in a fiduciary capacity and in actual control of the foreclosure proceedings in the state court as opposed to the balance of the bondholders representing a substantial minority but not a party to said foreclosure proceeding. The Circuit Court of Appeals in this case has overlooked and has failed to give effect to that portion of the Marine Harbor Properties opinion which speaks of the safeguards which Chapter X affords where the steps in the reorganization are in the control of those persons who with selfish interests could be guilty of much abuse. Under circumstances where such persons are in control the interests of all creditors would not be best subserved in the prior proceedings, as defined in Section 146 (4) of Chapter X. The juxtaposition between the instant case and the *Marine Harbor* case is founded in the fact that in the *Marine Harbor* case there was no clash of interests or dispute between the only class

of creditors who could possibly be affected by either the reorganization or the foreclosure proceedings. Whereas in the instant case the contrary is precisely the situation for which relief is sought.

CONCLUSION.

We submit that the factors which warrant relief in this case are:

1. The opinion of the Circuit Court of Appeals for the Seventh Circuit misapplies the holding of this Court in the *Marine Harbor Properties, Inc.*, 317 U. S. 78 (1942).

2. The decision of the Circuit Court of Appeals if permitted to stand would bar petitions under Chapter X where a state court foreclosure proceeding is pending even though the state court proceedings are inadequate as compared to Chapter X, and a conflict exists between creditors.

WHEREFORE, it is earnestly urged that certiorari be granted by this Court, requiring the Circuit Court of Appeals for the Seventh Circuit to certify the record in this case to this Court for review and determination.

Respectfully submitted,

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